

APARTMENT ADVISORY

AUGUST 2018

The big news in multifamily development over the past four years has been volume, with unprecedented levels of new apartment stock hitting the market at a rapid pace. But it's important to point out that developers are not building the same product they were fashioning a decade ago.

The composition of new supply has transformed, with the newest apartment projects trending toward taller, denser product. An industry that once emphasized building in remote suburban sprawl has shifted focus toward more urbanized, infill creations for the modern renter.

Annual supply in the nation overall has been running at an elevated pace of about 250,000 units or more since 2014, well ahead of historical norms. New additions in the past year amount to an existing base increase of nearly 2%. Back in 2001, inventory was increasing by a much more reserved 1.3%. But that's not all that has changed.

Throughout 2001 to 2007, new apartment supply consisted mostly of garden-style units. Out of the projects completed during 2001, roughly 84% were just one to three stories tall. The remaining 16% of deliveries were four stories or taller. The ratio of garden-style product eased almost every year until 2010, when a balance was struck - half of all new completions were garden-style and half were four stories or bigger. By then, the country was



recovering from the Great Recession and apartment deliveries had slowed to a crawl, bottoming out at a 15-year low of roughly 75,000 units nationwide in 2011.

Apartment construction activity across the nation started to regain momentum in 2012. By 2014, new supply reached decade highs and has continued to climb. But the makeup of this increased volume of product has evolved. Developers

are now more likely to build in downtown and inner-suburban locations near employment and transit hubs. Though construction sites in these prime areas tend to face challenges like higher upfront costs and strict permitting processes, renters - and in turn, owners - benefit from existing infrastructure and prime employment proximity.

With an increased volume of urbanized product, height and density have also increased.

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Driving construction activity in the postrecession period were starts on taller, denser product and by 2013, garden-style units comprised less than half of all new inventory delivered. Since then, the shift has become increasingly more pronounced, with the percentage of low-rise, garden-style product falling every year, dropping as low as roughly 33% in 2017.

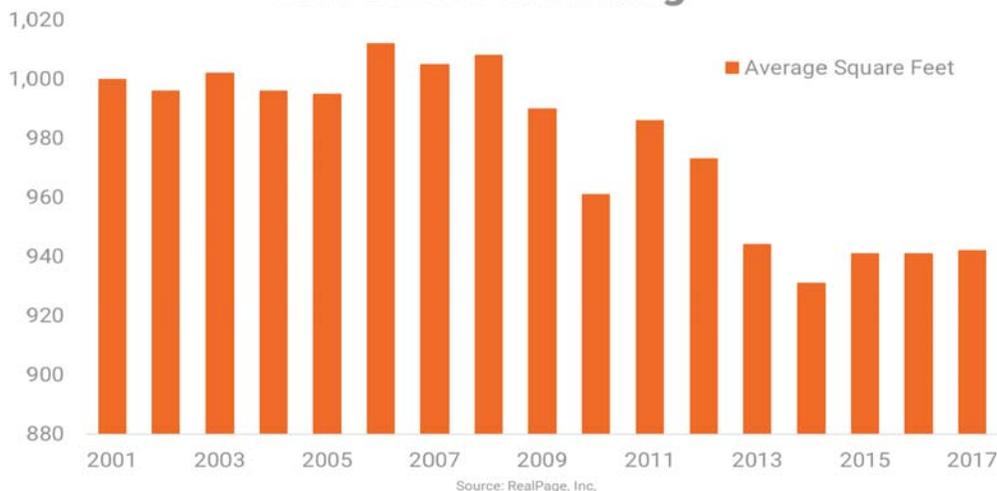
Meanwhile, completions of mid-rise and high-rise units have accelerated. Projects with four to six stories comprised about 47% of deliveries in 2017, while properties with seven or more stories accounted for roughly 20% of completions.

Inspiring this transition into dense infill product is the lifestyle choice of the millennial renter, who trends toward an urbanized setting close to entertainment, employment and public transit.

Additionally, these types of projects make sense from a developer perspective. As up-front development costs such as land prices and construction expenses increase, margins are strained, and denser projects on smaller sites in optimum locations offer the sense of sustainable long-term tailwinds.

With increased density, it's not surprising that the size of individual units has trended downward. In 2006, the average size of an apartment in the U.S. peaked at over 1,000 square feet.

Unit Size is Shrinking



Since then, the floorplan of the average apartment has decreased. Since 2015, average unit dimensions have hovered close to 940 square feet. With expensive up-front costs and barriers to entry to the urban landscape, developers are shrinking unit sizes to make finances pencil out and to cater to the millennial crowd, which tend to favor smaller units.

Not surprisingly, the cities with the biggest share of high-rise units completed since 2010 were prime urban locations with strong infrastructures. Five of the Gateway markets were among the leaders on this list: Washington, D.C., New York, Chicago, Los Angeles and Boston.

Topping the list for the most mid-rise completions in the past eight years was the high-development center of Dallas, and three Gateway markets: Washington, D.C., Los Angeles and Boston.

The bulk of the new supply for these metros came between 2014 and 2016.

Adding more garden-style units than any other U.S. markets since 2010 were the four big Texas locales - Houston, Dallas, Austin and San Antonio. The remaining low-rise leaders were also generally located in the South, which tends to enjoy fewer construction regulations, cheaper land costs and a greater abundance of labor access.

Looking ahead, this trend toward taller, denser product is expected to continue over the next few years. Among deliveries scheduled to complete in 2018, the share of garden-style projects is slated at less than 30%, while that share drops to just 19% when looking at 2019 anticipated supply. At the same time, the volume of projects with seven or more stories is slated to increase, with high-rise units making up 23% of all completions in 2018 and 33% in 2019.